DOW THEORY LETTERS INC.

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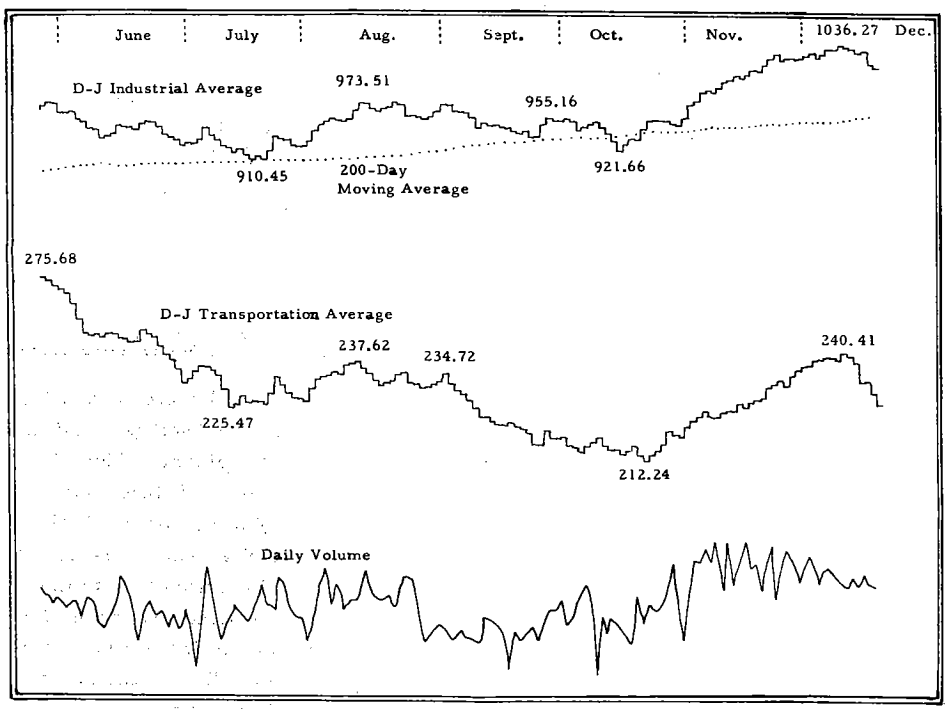
Dec. 8, Dow 1033.19, PTI 1049, A-D ratio -.86
Dec. 15, Dow 1027.24, PTI 1035, A-D ratio -1.50

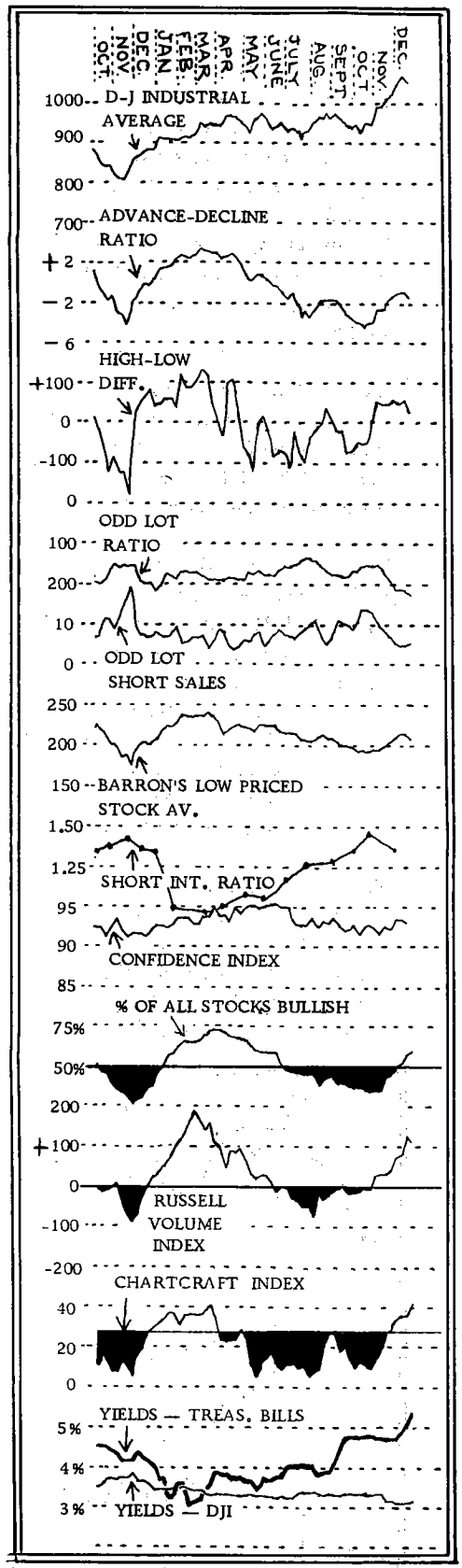
PERSPECTIVE: The New Year 1973 is just around the corner, and the stock market barometer is carefully sifting the evidence for the period ahead. In the last report I described two opposing views of the situation, and I stated that I held to Schaefer's view that everything now going on is part of a massive, inflation-inspired bear market rally. A few Dow stocks are near their all-time highs, some growth and glamor stocks are near their highs, but the great majority of issues on all exchanges are still far below peaks seen in 1968 and early 1969. Rosy forecasts do not produce market profits, they do not bring back stock losses, and they do not necessarily draw the public back to Wall Street.

The world scene is now one of monetary deterioration. In Italy the inflation rate is 6.9%, in Britain 7.5%, in France 6.7% and on and on. France and Germany have in the past suffered utter chaos and collapse because of inflation, and it seems impossible that they would stand by and allow inflation to run amuck in their nations again. But so far, the politicians and the people have been weak — and the forces of inflation have been strong.

Last week I received a report from a keen financial observer in Switzerland. Following is an excerpt from his letter: "The Government of Great Britain has lost control of their nation to the Socialist labor unions with strikes, exports below imports, and their currency, the pound sterling, crashing. Italy is being wrecked by union strikes, exports below imports, and a weak currency. The great German 'sellers' boom is over. France is now troubled by strikes. Inflation is rampant in all of these nations. Switzerland's inflation rate is now 10% and rising. Bull markets don't hold up long under these worldwide conditions."

In the last Letter I noted that a number of my monetary and other indicators were saying "trouble." As seen on the chart below, the Averages struck their highs on





December 11, Industrials at 1036.27 and Transports at 240.41. On December 14 Transports broke badly on reports of vicious Airline competition from overseas. Then over the weekend came news that the Kissinger negotiations with Hanoi had fallen apart. To the tune of the heaviest air raids of the entire war, the market headed for lower levels. Since the danger signals had been flying the week before, it was no surprise to see the Dow off over 13 points on Monday, December 18, or another four points the following day.

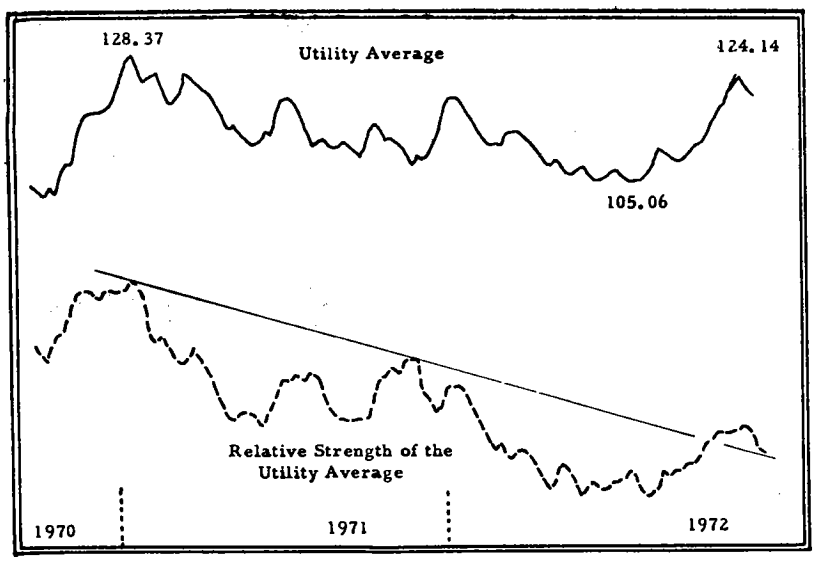
I never like to get too caught up in the short-term picture, since it is so easy on Wall Street to miss the forest for the trees. On the chart on this page we see the three Dow Averages and the A-D ratio plotted weekly. The picture is as follows: The Industrials have rallied to an all-time high. The Transports have stalled out and turned down, having failed to recover even half of their 1972 losses (the halfway point of the 1972 decline would be 243.97, but the December Transport recovery high was 240.41). Thus, Transports appear to have formed a huge top. Utilities advanced to 124.14, but this is below their 1971 high of 128.37, and seems to represent just one more rally peak in a long series of declining tops and bottoms which began in 1965.

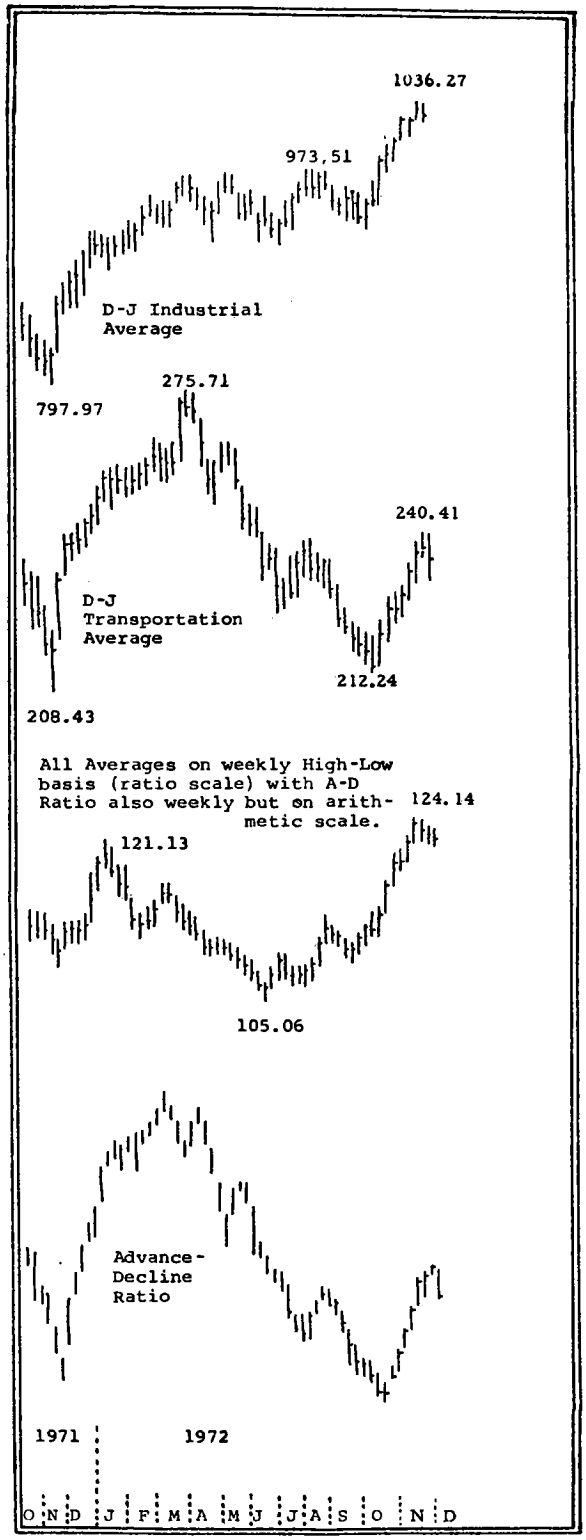
Measured against the rise in Industrials, the rally in the advance-decline ratio has been pitiful, one of the least impressive on record. The fact is that with the Dow over 1000, the A-D ratio is much nearer its 1971 low than its 1972 high. And that takes some doing, the "doing" being massive resistance by the main body of stocks to the advance.

The lack of breadth is further documented by the tabulations of weekly new highs minus new lows. This figure hit a strong plus 432 on the week of April 16, 1971, this with the Dow at 940. Again on March 3, 1972, with the Dow at 942, the weekly high-low plurality hit a high of 295. Recent figures are as follows:

Nov.17, 1972, Dow at 1005, high-low plurality 108.
Nov. 24, 1972, Dow at 1025, high-low plurality 149.
Dec. 1, 1972, Dow at 1024, high-low plurality 131.
Dec. 8, 1972, Dow at 1033, high-low plurality 158.
Dec. 15, 1972, Dow at 1027, high-low plurality 124.

The implications are obvious. The statistics show that there were about one-third as many new highs when the Dow went over 1000 in 1972 as there were in 1971 when the Dow was at 940! Is there any wonder that the public has not flocked back into the market? (Note: The page 1 composite chart shows the plurality of highs and lows on a daily basis, and here too the picture is roughly the same as the weekly high-low picture).





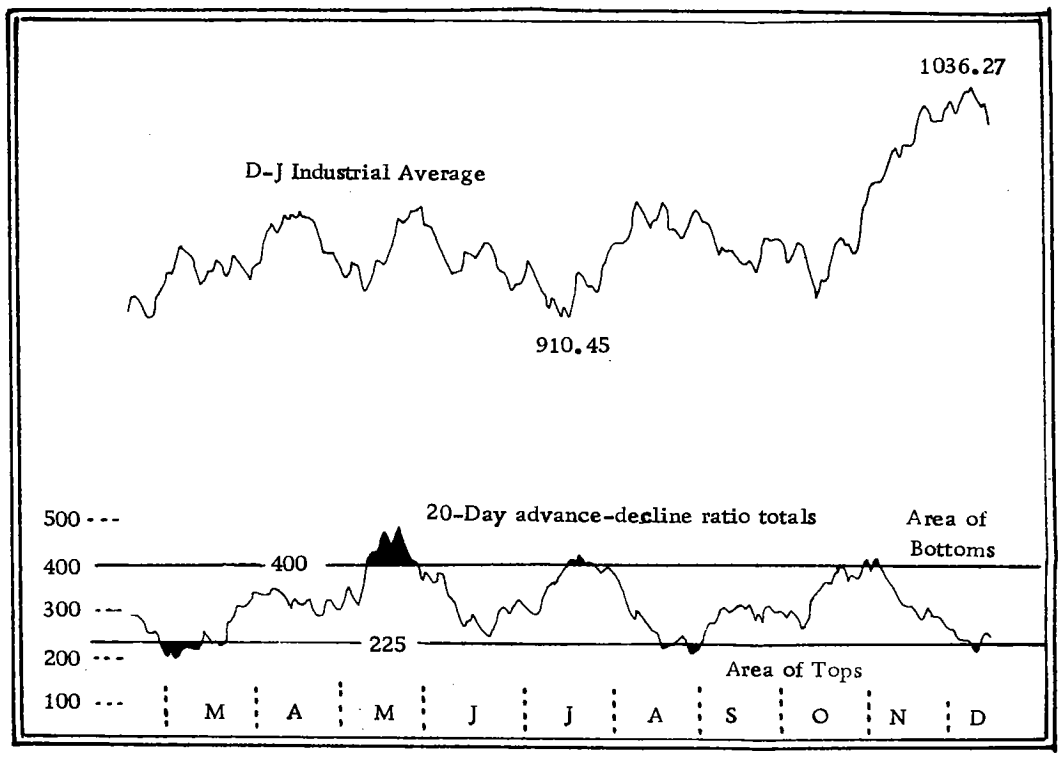
UTILITIES: In the last report I wrote quite a bit about the Utility and the Bond Averages, and their relationship to the monetary picture. Much has been made of the recent rise in Utilities which has taken the D-J Utility Average from a 1972 low of 105.06 to a recent 1972 peak of 124.14. In studying my chart, I was interested to note that the 1972 Utility peak was 4 points under the 1971 peak of 128.37, but even more interesting is the relative strength line (dashed line on the accompanying chart) for the Utility Average.

It should be remembered that the Utility Average topped out in 1965 at 163.32, and it has been in a major bear market decline ever since. The question during each rally in Utilities is, of course, "Could this be the real turn?" I feel that the relative strength chart is of some use in answering this question. For the fact is that after a seven year decline, the latest rally in Utilities has failed to turn in a strong relative strength performance. As such, it was just another one of the periodic Utility run-ups which have punctuated the last seven years of decline in this Average.

TECHNICAL PROBLEMS:

In the last Letter I presented a series of monetary indicators and commented that these indicators were forecasting trouble for the market to arrive around the last weeks of 1972 or during the opening weeks of 1973.

In view of the timing of the monetary indicators, I thought it would be interesting to present a market indicator which I have found most effective in calling short to intermediate term market action. This indicator is based on the action of the advances and declines, and it tends therefore to deal with broad market rallies or declines. I have shown this indicator on the accompanying chart along with the D-J Industrial Average.



In order to understand this tool, readers should understand that during a market advance the plurality of advances over declines usually starts out fairly strong. But as the advance nears a top area, the pluralities get smaller and smaller until at or near the final top advances and declines are often equal (pluralities are very small). On the other hand, during a decline the pluralities of declines over advances usually expands, so that near the bottom there are often huge pluralities of declines over advances (the proverbial selling climax).

The indicator shown is simply a 20-day moving average of the daily A-D ratio figures. It does not matter whether the figures are plus or minus, this index is just a 20-day total of all plus and minus figures. When the 20-day totals drop to or below 225, it means that there has been very little movement in the A-D ratio (churning), and this usually suggests a top area. These 225 or less levels are seen on the chart in the "Area of Tops" as solid black spaces.

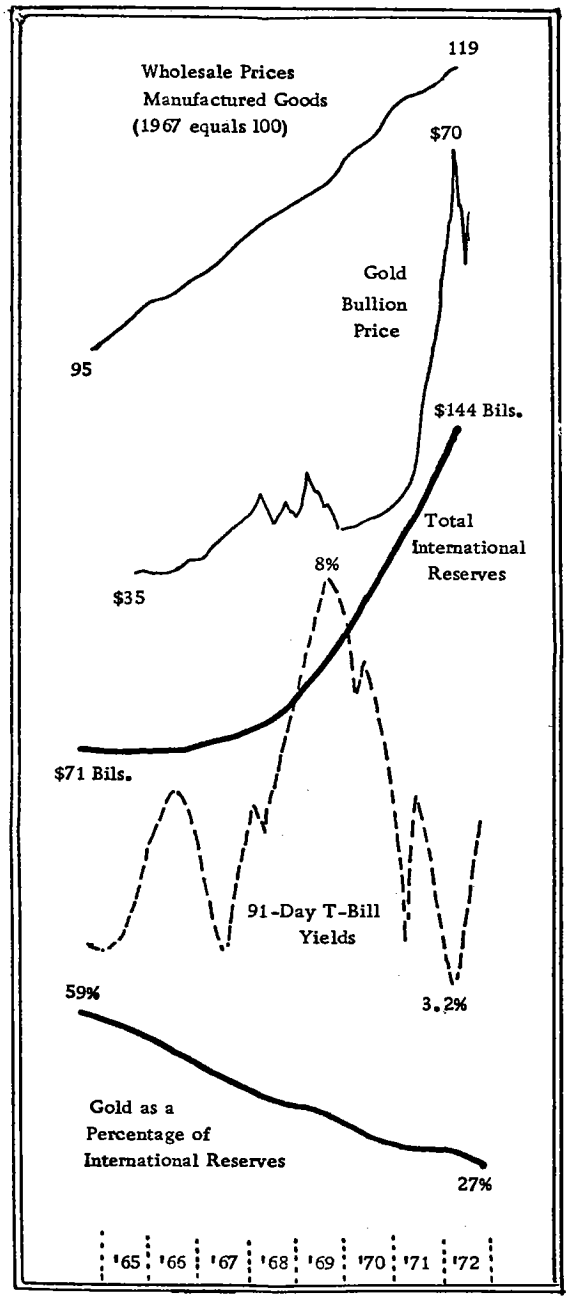
Conversely, when the A-D totals are 400 or more they are shown in the "Area of Bottoms," and these too are shown in solid black. Note that the first "top" signal for 1972 came in early March. This proved to be the 1972 top for the A-D ratio, and as such it was a most important signal. Next came a bottom signal at mid-May, and this brought on nothing but a little rally in the Dow and the A-D ratio.

The indicator did not get back to the top area on the next decline, but in July it registered another bottom signal. Again the Dow rallied back to the 973 area, although the A-D ratio continued rather sluggish. In August a top signal was given, and this brought on a decline to the October low, at which point the A-D ratio smashed to a low for 1972.

In early November a bottom signal caught the Dow at 955, and from here the Dow and the A-D ratio entered the first impressive advance of 1972. On December 11 the index dropped to 213, thereby signalling an area of tops. This occurred with the Dow at 1025.27. My feeling is that the A-D ratio and therefore the majority of NYSE issues will now stall out, "churn" and work lower. The latest top signal also comes within the area of the monetary danger signals as noted in the last Letter.

Thus, the market, I feel, will now face an important test, and it will be most important to watch the quality of the action between now and the next bottom signal on the 20-day A-D totals. I will keep subscribers informed regarding this index as well as the monetary indices. In the meantime, I believe the "gravy" is over for the latest rally, and that the quality of the action during January could set the tone for all of 1973.

THE CONFRONTATION: In Letter 548 I included two charts, one showing international reserves in terms of paper money and gold, and the other chart showing the price of gold. I am now presenting another chart in this series. This chart adds three more crucial indicators. If the chart appears "complicated," then summon up all your energy and capacities, because it is most important to understand what is pictured here.



The top line represents the wholesale price of manufactured goods. This is a good index of the effects of inflation. Since 1965 this line has been steadily rising, from 95 to 119. This index is saying that inflation is rampant. Why is inflation running at such a persistent and flagrant rate? We shall see.

The first heavy black line shows total international reserves including all paper currencies, dollars, sterling, IMF funds and gold. Since 1965 international reserves have doubled, from just over $70 billion to just over $140 billion. And this would be all right in an expanding world economy except for the problem of the heavy bottom line. This line shows the percentage of gold in the total world reserves picture. That percentage has dropped from about 60% in 1965 to 27% today — or roughly in half. What does this mean? It means that the world is in the paper manufacturing business or the business of printing fiat money for its reserves. In all history, when this has happened the outcome was a final inflationary orgy and then panic and collapse.

Why the collapse? Because in every poker game there comes a time when the participants want to cash in their chips. The chips of the world today are oblong pieces of paper. The ultimate value, which the participants hope to cash in their paper for, is gold. But the pile of chips gets larger and larger, and the pile of gold stays the same. What's going to give? It could be the price of gold, which if doubled or tripled, would obviously supply a much larger percentage gold base for international reserves. Or confidence could give, sending paper money holders scrambling for silver and gold — in other words, turning in their chips. At any rate, as the paper pile gets larger and as the percentage of gold gets smaller, the pressure grows.

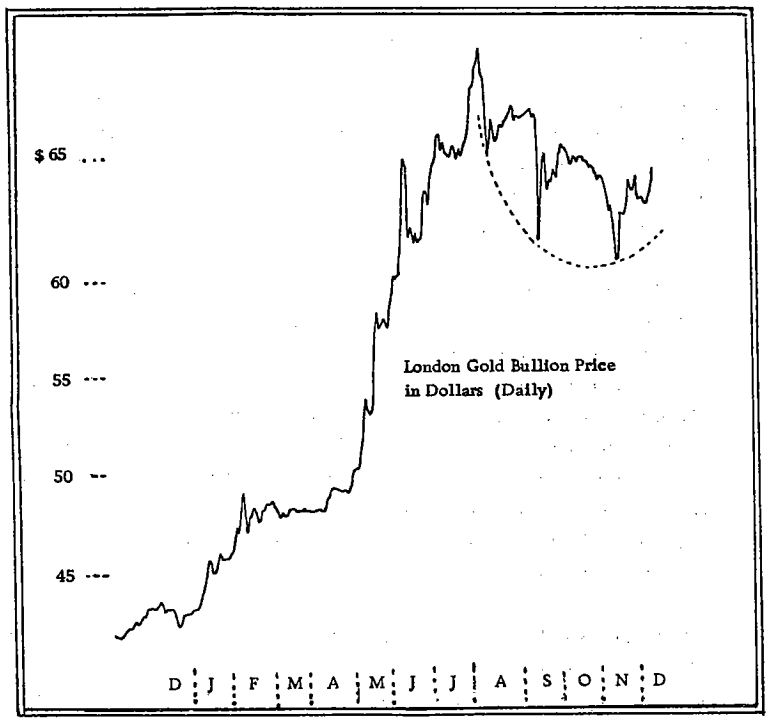
All of which brings us to the dashed line in the middle of the chart. This is the yield on US 91-day Treasury bills. The yield on these bills represents a bellwether of short-term interest rates. These yields also constitute a US weapon, for when the yields move up they (1) compete with stock market yields, forcing stock prices down, (2) attract foreign money and siphon off foreign reserves, (3) exert a deflationary effect, in that rising Bill yields signal a general tightening of interest rates, and this in turn makes money more expensive to borrow, and it also makes savings more attractive. For example, if short-term interest rates (God help us) rose to 15%, people would be selling their houses and their pet poodles and putting the money into bills, notes and bonds. Inflation would end with a bang heard around the world.

Bill rates are not totally open to Government manipulation, they are also influenced by the law of supply and demand. For instance, foreign central banks hold billions of dollars of T-Bills. If, for any number of reasons, foreigners want to sell a portion of these T-Bills, the market must absorb them. Bill rates then go up. Of if the Treasury decides to raise (borrow) a certain amount of money through T-Bills, rates are liable to go up. The fact is that any number of factors can affect bill rates, including massive spending by corporations which ordinarily put major portions of their idle money into bills.

Currently, the yields on Bills are rising. In the last Letter I included a special section on the market and monetary indicators, and I showed that all the monetary indicators on the chart (Utility and Bond yields, Will-Go, the Aaa-Bill yield ratio) were suggesting monetary dislocations ahead, dislocations which would affect the stock market.

Right now I am particularly interested in the movement of T-Bill yields. Note on the chart that the 1971 yield peak on T-Bills was about 5.4%. A number of factors are now suggesting that bill rates are headed higher, factors which include big deficits, rising foreign interest rates (which are competitive with ours) and continuing high inflation. I would consider a move by 91-day T-Bills above 5.5% as a breakout and as ominous for the area ahead.

As the year 1973 draws closer, I want to do something I have not done before. I am including a daily chart of the London gold price. What we see here is, I feel, most fascinating. Basically, what I want to show is the 1972 consolidation-correction of the massive 1970-72 rise (from $35 to $70). Following the August, 1972, peak of $70, gold broke to a low of just over $61 in September, then to just over $60 in November. But note the extraordinary "rounding bottom" which has formed. In mid-November the descending trendline was reversed to the upside, and here in December the price of gold is gathering strength again.



Obviously, the following is only a guess, but I am guessing that the gold price will head up forcefully during 1973 with possibly a new high above $70 during the first quarter. If this occurs, then renewed attention will be focused on the gold shares and the whole meaning of gold and inflation.

I have been writing all along that I feel that the ultimate outcome of world inflation will be panic and a flight into the protection of gold. At what point casualness will turn to interest, interest to strong interest, strong interest to fascination and fascination to frenzy I do not know. But I do feel that the ultimate outcome of world inflationary policies will be panic and a frenzy to own gold shares. Whether 1973 or 1974 (or perhaps 1975) will be the fateful years I do not know. Perhaps the gold chart will be our best barometer, and that is why I continue to run the gold-silver chart.

So we are entering 1973 with gold probably completing a powerful consolidation following a doubling of its old $35 price. A rise above the August high of $67.50 and than a rise above $70 would start the fireworks. We'll watch for all this to begin.

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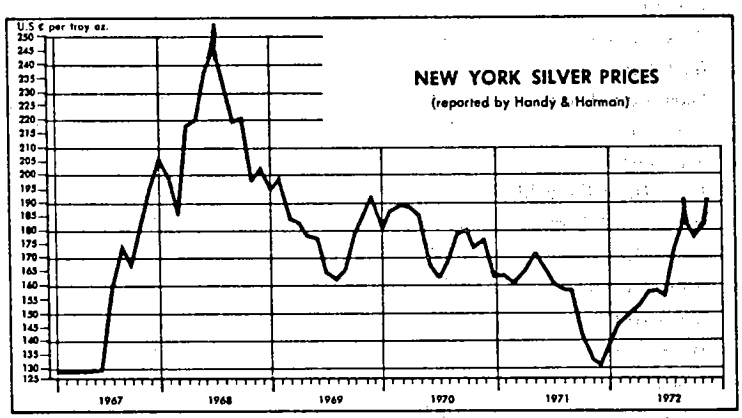
SILVER: I am including a long-term chart of silver (from E. Geo. Schaefer's, "Stocks, Bonds, Real Estate & Money" Report, 910-916 E. 38th St., Indianapolis, Ind. 46205) and of course the reason I am including this chart is obvious. Silver appears ready to break out over the $2.00 level, a move which would take it to its highest level since 1969. Note also that silver seems to be moving in a great "head-and-shoulders" bottom with a breakout coming at $1.95.



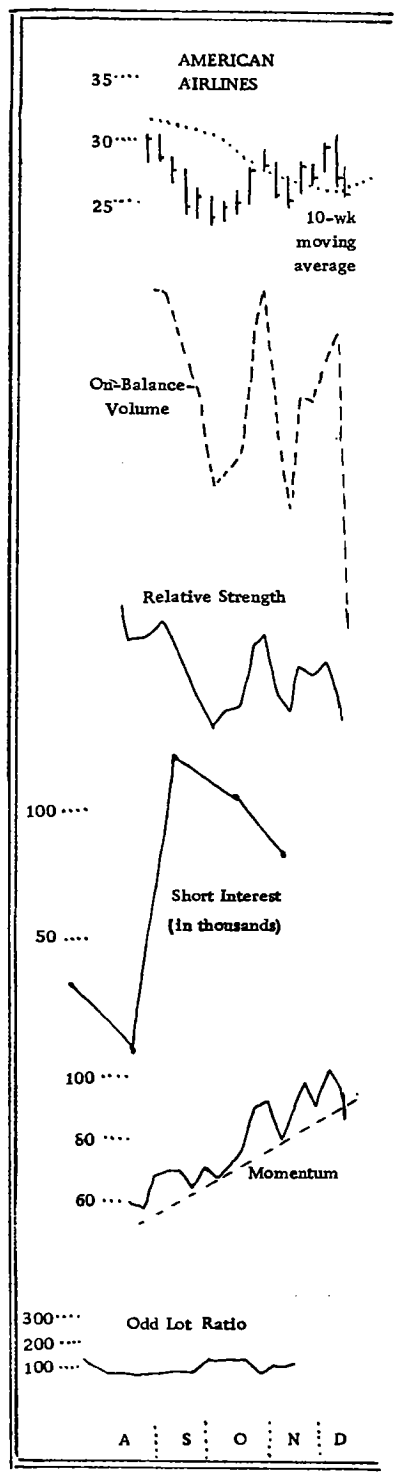
Many months ago I recommended a trade in Sunshine Mining convertibles, which went from 80 to 90 (at which point I suggested sales). Sunshine is about to go back into production following its mining disaster, and for those wanting a conservative silver commitment I would suggest again the Sunshine convertibles with a coupon of 6.5%. The bonds are now selling in the low 80's, are far from conversion, but will tend to move up in gear with the common.

I feel that the silver move here is linked to gold, and that it is part of a coming giant trend towards the safety of precious metals. The silver advance is also interesting, since it seems to be progressing with little fanfare and an absence of speculators. The speculators, if you remember, were all wiped out in the 1968-71 silver decline. I doubt that you could "give" silver to them on the current advance, which is par for the course on Wall Street when the real thing comes along.

STOCKS: Each week I tabulate the rating on each of the thirty Dow Industrial stocks. The latest reading shows nine Dow stocks with a "high" rating of 4 or better (6 is the highest rating) and two with ratings of zero or 1. The number of high ratings is beginning to drop, with 12 high ratings (4 or more) on November 27, 12 on December 5, 13 on December 12 and 9 on December 18. I also total all the ratings in the 30 Dow stocks each week, and the totals for the same four weeks ran 96, 95, 96, and 85. Thus the Dow strength on the basis of my charts (which I feel are the most comprehensive technical charts anywhere) is beginning to ebb.

I follow six of the D-J Transport issues on the same basis as the Industrials. The Transports, as discussed in a previous section, are now weakening, and one of the more dynamic sectors, airlines, is showing considerable weakness (actually, for the first time in many months all three Transport sectors, rails, airlines and motor freight, are now declining in relative strength).

I am including a technical chart of one of the Dow Transport airlines, American Airlines. Here we see what has been happening over the past five months. Last week OBV broke very badly, smashing through all the lows of the past half year. RS has been erratic but is now turning down. The high short interest could be a technical plus, but this has been declining over the past two months. Momentum failed to climb over 100 and has now turned down on a trend basis. And for some strange reason, the odd-lotters continue to "like" Amer. Airlines, so that despite heavy selling in most other issues, odd-lots are barely on the sell side in Amer. Airlines. All in all, the chart indicates a deteriorating situation, and one which does not bode well for the Transport Average in general.



GOLD ADDITION: In the last report I noted that working profits of the S. African mines during the quarter ending September, 1972, were double the comparable 1971 quarter. My thanks to Mr. F.A. Harper (Institute of Human Studies, Menlo Park) for the following statistics, which I feel are well worth studying.

Cost of $1 of Gold Production Rate (Based on third quarter, 1972, gold production and late October London gold share prices). Since share prices are now lower than listed here, the P/E ratios are now lower and the shares even more attractive.

Mine	Gold produced per $1 share price	3rd Quarter, 1972, earnings rate	London price of share, Oct. 1972.	P/E ratio
East. Rand Prop.	$1.82	$1.08	$4.70	4.3½
Harmony	.88	.40	3.54	8.9
Welkom	.84	.97	4.05	4.2
Loraine	.77½	.20	1.68	8.4
West. Areas	.69	.52	2.97	5.7
Buffelsfontern	.59	1.12	9.67	8.6
Hartebeestfontern	.56	3.40	12.25	3.6
Libanon	.55	1.03	8.72	8.5
Blyvoors	.54	.62	5.00	8.1
Free State Geduld	.50½	4.16	17.58	4.2
West. Holdings	.42	5.68	28.30	5.0
Pres. Steyn	.42	1.10	10.07	9.1
Pres. Brand	.40	3.36	14.05	4.2
Vaal Reefs	.37	2.96	17.80	6.0
West. Deep	.35½	2.00	12.50	6.2½
Elsberg	.20	.13	2.76	21.2
Kloof	.19½	.96	9.10	9.5